

**Alabama Trust Fund
Board of Trustees Meeting
May 22, 2014
State Capitol, N-202**

Pursuant to public notice, a meeting of the Alabama Trust Fund Board of Trustees was held on May 22, 2014. The meeting was called to order at 1:30 PM by Vice Chair Newton. The roll was called by Secretary Boozer and recorded as follows with a quorum present.

Present:

Mr. Bill Newton, Vice Chair
Mr. Young Boozer, Secretary
Dr. Sandra Sims-deGraffenried
Mr. Guice Slawson, Jr
Mr. Sam Upchurch

Absent:

Governor Robert Bentley, Chair
Mr. Daniel Hughes
Mr. Rich Bielen
Mr. Terry Bunn

The first order of business was review and approval of the minutes of February 20, 2014. Upon motion made by Mr. Upchurch, and a second by Dr. Sims-deGraffenried, the reading of the minutes was dispensed and the minutes were unanimously approved as presented.

Mr. Boozer reviewed the quarterly financial reports. He noted assets of \$2.8 billion are slightly higher than at December 31, 2013. Quarterly revenues of \$62 million were offset with quarterly distributions of \$66.7 million. Royalty payments are fairly steady at \$21 million for the quarter, and \$40 million fiscal year-to-date. Other reports were reviewed. Upon motion by Dr. Sims-deGraffenried, and second by Mr. Slawson, the reports were received by unanimous consent.

Ms. West presented the quarterly investment performance measurement report and market overview. She noted that all the broad asset classes had positive returns for the quarter. First quarter GDP growth was below expectations; however, consumer sentiment was up giving cause for future potential growth. Unemployment in Europe remains high with recession still lingering. Japan was the worst performer.

In comparing the actual ATF asset allocation to the target asset allocation, Ms. West noted a slight overweight to domestic equity but still within the rebalancing ranges. The quarterly total fund return of 1.15% is below the target return of 1.62% with the international equity managers detracting from value. The one year total fund return of 11.23% is 1.09% above the benchmark return. The value added by the managers as a group as well as the underweight to fixed income during this period was the main contributing factor to the outperformance. Manager effect was the driver behind the outperformance over the 5-year period, with the fund up 12.24% versus the target return of 10.73%. Total invested assets decreased slightly from December as a result of \$46 million distributed from the trust fund against an investment return of \$29 million.

Ms. West reviewed the quarterly returns. Atlanta Capital struggled for the quarter; however, has outperformed over longer periods. Vulcan Value Partners was hired last year as a small cap manager to complement the two incumbents and will be funded once the contract has been finalized. Thornburg had a horrific quarter and will be discussed in more detail when reviewing the watch list. GMO has performed well since inception. It was noted that American Century was selected by the board last year as an additional manager in the small cap international space, and their funding is also awaiting finalization of the contract. Wells Cap, the emerging markets equity manager, has struggled for the quarter and the year. The fixed income managers had a good quarter. Sterne Agee trailed the benchmark and the median core fixed-income manager over the 1 and 3 year periods and will present at the August meeting. Under real estate, it was again noted that UBS has been hired last year and will be the third real estate

manager once the contract has been finalized. Ms West discussed the management changes At Aberdeen to occur at the end of the year. There is no concern as this is a planned event.

Ms. West reviewed the Watch List. She recommended that CS McKee and Sterne Agee remain on the Watch List. She recapped recent investment management changes at Thornburg resulting in one portfolio manager managing the portfolio going forward versus the 3- person team that has handled the portfolio the past seven years. Other concerns were mentioned such as the significant recent underperformance. Callan's team has met with Thornburg to discuss the portfolio management changes and performance issues. Ms. West recommended termination due to the management changes and underperformance. In following up to a memo distributed earlier to the board regarding Batterymarch, Ms. West recapped that QS Investors had acquired Batterymarch. Initially there was delay in announcing the team that would manage the mandate that includes the ATF and CMT accounts. While the team is now expected to remain in place, assets under management have decreased and the ATF is a large portion of the mandate. Ms. West expressed concerns about the future of the strategy. Based on organizational changes, she recommended termination. Upon motion made by Mr. Upchurch, and a second by Dr. Sims-deGraffenried, the board unanimously approved the recommendations.

Ms. West reviewed the April flash report noting that the markets recovered late in the month from the volatility earlier in the month. The small cap asset class struggled; however, the ATF managers did beat their respective benchmarks. CS McKee and Wells Cap had good performance. Assets decreased \$62 million as a net result of distributions of \$71 million and realized gains of \$8 million.

Under decision items, Ms. West noted that the board materials include a recap of the RFP process for international equity managers that the board approved at the last meeting. Also included was a summary of the finalists determined by the Investment Committee. Mr. Boozer stated that the Investment Committee interviewed the six candidates that morning. He stated that the committee recommends hiring Artisan Partners, INVESCO, Lazard Asset Management, and Thompson, Siegel & Walmsley LLC to manage monies for the ATF. He also noted that the Committee proposes that the allocation to each manager be determined by the Investment Committee upon recommendation by Callan, and ratified by the Board. Due to the nature of the transition, it was noted that the Committee also discussed and recommends that a transition manager be hired. Mr. Boozer restated the recommendations as a motion, with a second by Mr. Upchurch, and it was unanimously approved.

In regards to the CMT and on behalf of the Investment Committee, Mr. Boozer made a motion to hire INVESCO and Thompson, Siegel & Walmsley to manage approximately \$90 million with the exact allocation between managers to be determined by the Investment Committee with further ratification by the Board. Mr. Upchurch seconded the motion, and it was unanimously approved.

The next order of business was the discussion of outside legal counsel. Mr. Boozer stated that, at the last meeting, the Board had discussed obtaining outside legal counsel with expertise in investment related issues. Mr. Cater mentioned that the trust fund investments were sophisticated beyond fixed income and equity, and the Board would be well served by this investment in legal counsel. Dr. Sims-deGraffenried made a motion to adopt the resolution included in the board package to engage outside legal counsel, a second was made by Mr. Boozer, and the resolution was unanimously adopted. (resolution attached). Payment of legal counsel was discussed and it was noted that the board had previously discussed requesting emergency funds from the Governor for FY14 and FY15, with the expectation that monies would be requested and appropriated for FY16. The constitutional amendment creating the Alabama Trust Fund states that the legislature shall provide for the administrative and other necessary

expenses in the same manner as it provides for operating other departments and agencies of the state. Mr. Cater noted that the constitutional amendment provides that the expenses of making and disposing of investments be paid from trust income, but does not appear to relate to overall legal assistance.

As an informational item, the Board again discussed the constitutional amendment proposed by Act 2013-266 and its effect on the ATF. Mr. Boozer noted that the CMT advisory committee expressed concern if it passed due to the negative affect on payments to the cities and counties. More information from the city and county associations may be available in the coming months. Dr. Sims-deGraffenried reiterated her concern about the proposed amendment. Further discussion will be held at the next meeting.

Ms. West provided a follow-up memorandum of information as requested at the last meeting regarding sanctions by the SEC and US Department of Labor against Western Asset Management. She noted that Callan representatives conducted an on-site visit with Western and discussed the investigation and settlement with Kevin Ehrlich and Ken Leech. Callan believes the incidents were unintentional. Improvements to trade oversight systems have been put in place to remove the possibility of similar issues occurring in the future. Callan does not recommend any action at this time.

The next order of business was to review the investment performance of the County & Municipal Government Capital Improvement Trust Fund ("CMT"). The full quarterly investment report was emailed to the Board, and summary information reviewed at the meeting. Ms. West noted that the assets of \$467 million recorded a total quarterly fund return of .76% to the benchmark of 1.58%. The underperformance was primarily a result of the manager effect detracting 72 bps, primarily from the international equity managers Thornburg and Wells Capital. The fiscal year to date total fund return is good at 11.34%. She noted that the real estate allocation with Heitman is in the queue and not yet funded. Ms. West noted that Regions had a good quarter at 1.5%, and a strong return of 1.2% for one year. The April flash report was also reviewed. Ms. West noted that the portfolio had \$1.4 million in gains for the month with a distribution of \$20.6 million. Upon motion by Dr. Sims-deGraffenried, and second by Mr. Boozer, the quarterly performance reports were received by unanimous consent.

There being no further business, the meeting was adjourned at approximately 2:30 pm.

Bill Newton, Vice-Chair

Young Boozer, Secretary